



LARGE AND MID-SIZE
BUSINESS DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

February 2, 2004

MEMORANDUM FOR LMSB INDUSTRY DIRECTORS AND MANAGERS

FROM: Bobby E. Scott /s/ Bobby Scott
Industry Director - Natural Resources and Construction Industry

SUBJECT: LMSB Industry Director Directive -Section 29 Credits Claimed on
Solid Synthetic Fuel from Coal – Significant Chemical Change Issue

This memorandum provides guidance for the Natural Resources and Construction Industry issue related to the significant chemical change requirement for non-conventional fuel credit under IRC Section 29. This LMSB Directive is not an official pronouncement of the law or the position of the Service and cannot be used, cited or relied upon as such.

Section 29 provides a credit against federal income tax for producing and selling a "solid synthetic fuel from coal". Synthetic fuels are defined under IRC 48 as a fuel which differs significantly in chemical composition from the alternative substance used to produce it. Coal is a qualified alternative substance. To qualify for this credit, a taxpayer must produce and sell qualified fuel from a production facility that was placed in service as of July 1, 1998, pursuant to a binding written contract in place as of January 1, 1997, and whose manufacturing process imparts a significant chemical change to the coal feedstock under the criteria of Revenue Ruling 86-100.

Taxpayers that have a Private Letter Ruling (PLR) and are claiming this credit have provided expert reports and test results as evidence that the manufacturing process imparts a significant chemical change to the coal feedstock resulting in a qualified fuel for purposes of Section 29. Taxpayers may then claim this credit for qualified fuel produced and sold through December 31, 2007.

On September 6, 2002, this office identified the Section 29 issue as an LMSB Industry Emerging Issue and announced the formation of an Industry Issue Administrative Guidance Team. (Reference the [LMSB Emerging Issue Announcement dated September 6, 2002](#).)

On June 27, 2003, in Announcement 2003-46, 2003-30 I.R.B. 222, the Service stated, in part, that it would review the scientific validity of test procedures and results presented as evidence of significant chemical change. The Service also stated that it would issue no additional Private Letter Rulings on the question of significant chemical change until the completion of the review.

On October 29, 2003, the Service released Announcement 2003-70, 2003-46 I.R.B. 1. It stated, in part, that the Service had finished the review started with Announcement 2003-46. As a result of this review, the Service determined that the test procedures and results used by taxpayers are scientifically valid if the procedures are applied in a consistent and unbiased manner. It further

stated that the processes approved under its long standing ruling practice and as set forth in Rev. Proc. 2001-30, 2001-1 C.B. 1163, do not produce the level of chemical change required by Section 29(c)(1)(C) and Rev. Ruling 86-100, 1986-2 C.B. 3. Nevertheless, the Service recognized that many taxpayers and their investors have relied on its long-standing ruling practice to make investments. Therefore, the Service concluded that it will continue to issue rulings on significant chemical change but only under the guidelines set forth in Rev. Proc. 2001-30, as modified by Rev. Proc. 2001-34, 2001-1 C.B. 1293.

As a result of these announcements, the Industry Director for Natural Resources and Construction is providing the following instructions for field personnel for ongoing and pending examinations of taxpayers with identified Section 29 credit issues.

For cases in which the taxpayer was issued a Private Letter Ruling stating that the taxpayer's process produced a qualified fuel for purposes of Section 29 (c) (1) (C), under the conditions set forth in Rev. Proc. 2001-30, as modified by Rev. Proc. 2001-34, issue development relating to the "significant chemical change" issue should be limited to confirming that the taxpayer has followed the approved process. If there are additional issues, such as placed-in-service, that need to be resolved, the field should continue their review. If there are any questions, contact PFTG Technical Advisor Don Sniezek.

For cases in which the taxpayer does not have a Private Letter Ruling, contact the Mining Industry Technical Advisor(s) at 312-566-2323 or 412-395-4558 for guidance. If upon further review the Technical Advisor(s) believes the process does not meet the requirements of Rev. Proc. 2001-30, as modified by Rev. Proc. 2001-34, examinations of the "significant chemical change" issue should proceed as necessary to determine if the claimed "significant chemical change", meets the requirements of Treasury Regulation 1.48-9(c)(5)(ii) and Revenue Ruling 86-100. If there are any questions, the field is to contact PFTG Technical Advisor Don Sniezek for audit applicability.

In resolving these cases, whether or not the taxpayer has a Private Letter Ruling, do not enter into a closing agreement relating to the qualification of the fuel produced from a coal feedstock for purposes of the Section 29 credit.

Additional guidance will soon be forthcoming on the factual placed-in-service issue requirement for this credit.

If there are any questions regarding this guidance, please contact PFTG Technical Advisors Don Sniezek @ 312-566-2323 and Dave Seery @ 412-395-4558 or NRC Program Analyst Paula Farmer @ 713-209-3940.

Cc:
LMSB Counsel
Appeals